Canadian Participation in USA - Mexico Free Trade Discussions

Preliminary Agricultural Perspectives

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INTRODUCTION

Earlier this summer, the United States and Mexico agreed to explore further the possibility of launching free trade negotiations.

The purpose of this paper is to provide a preliminary assessment from an agricultural perspective whether it would be in Canada's interest to participate in these negotiations.

Economic and agricultural policy developments in Mexico

With an annual population growth rate of over 2%, the population of Mexico is expected to reach 105 million by the year 2000. However, Mexico's economic growth has not kept pace with its demographic trends. Hence, the need for economic policies that will ensure economic prosperity to this growing population.

Country General Information

1988 basis	Population Million	GNP/capita US $	GNP/capita 80-88 growth
Canada	26.1	16,760	2.3%
U.S.A.	245.9	19,790	2.1%
Mexico	83.5	1,820	-1.4%
Total	355.5		

The economic strategy pursued by the Mexican government included various measures designed to moderate inflation and stabilize the economy; many sectoral reform programs were set out in support of an opening of trade and softening of foreign investment restrictions.

Hence, under certain conditions, restrictions have been removed on foreign investments of less than US $100 million in most industrial sectors. 100% foreign ownership is now allowed in different sectors like mining, auto parts manufacturing as well as the agri-food sector. Many privatization operations have also been conducted; about 650 state-owned firms have been dismantled, consolidated or sold.

A major economic reform has been Mexico's accession to the General Agreement on Tariffs and Trade in 1986. Consequently, Mexico has greatly modified its import regulations and has significantly reduced barriers to trade. Mexico implemented a much more open trade regime by reducing tariffs significantly, harmonizing the tariff structure, abolishing official prices and removing most import licensing requirements.

All Mexican tariffs were bound to 20%. As a result, the average tariff rate is now only 6%. Mexico has five years from December 1986 to complete adjustments to its tariff structure. So far the import licensing requirement has been eliminated on 96% of the tariff categories. However, 60 agricultural products categories, including grains, oilseeds, dairy goods and certain horticulture products still require import permits. Over the 1987-89 period, these commodities accounted for 85% of the Canadian agri-food exports to Mexico. Recently, the import permits which served as the mechanism to enforce the quantitative restrictions, are issued more readily.

Part of the Mexican economic strategy has been to undertake negotiations with trading partners. For instance, before launching Mexico-U.S. trade talks, Mexico had already negotiated with Chile a free trade deal that will be signed on October 4, 1990. Further trade agreements will likely occur as Brazil and Argentina are looking forward to construct a common market by 1994 including Chile, Uruguay and Paraguay. Current trends point towards the development of larger regional trading groups. This underscores the need for Canada to position itself to take advantage of these new trade alliances.

Agricultural Trade Situation

From 1982 to 1988, the combined value of USA and Mexico agricultural trade increased by 57% to reach over $4 Cdn billion. During the same period, the USA has been Mexico's major supplier of agricultural products and the largest market for Mexican agricultural exports. In contrast, Mexico's agricultural trade with Canada is small.

Agricultural Trade: 1989, million $Cdn

Exports to: From:	Mexico	USA	Canada
Mexico	0	2,372*	110
U.S.A.	1,867*	0	4,189
Canada	150	3,109	0

* 1988 Figures

However, despite its relative smallness, Canadian agricultural trade with Mexico can be of significance to some commodity sectors and may offers potential market developments for others.

In the future, Mexico may have to rely more on imports to supply basic foodstuffs to its growing population because of limiting agricultural conditions such as restricted water supplies and a limited arable land base. Furthermore, changes are expected in the eating patterns of Mexicans due to urbanization and the higher incomes that may result from enhanced economic conditions.

Exports

Mexico is Canada's 15th largest export market for agri-food products, accounting for about 1% of such exports. Over the 1987-89 period, agri-food exports to Mexico averaged $149.1 million. The share of total exports to Mexico accounted for by agri-food products has increased over the last twenty years; rising from about 10% in 1970 to an average of almost 28% in the 1987-89 period. Mexico is Canada's largest market for skim milk powder and second largest for canola. Other important exports include grains dairy cattle and pork products.

Several commodities are considered to have good potential for increased exports to Mexico. These include special crops (canary seed, lentils, coloured beans and selected forage seed), breeding livestock (swine, dairy and beef cattle), pork and edible offals.

Imports

While Mexico is the 8th largest supplier of agri-food products to Canada, it accounts for less than 2% of total food and agricultural imports. Over the last three years, agri-food imports averaged $117.7 million or about 8.4% of all Mexican exports to Canada. The majority of imports are unprocessed products and do not compete directly with Canadian production. For instance, imported vegetables are largely complementary, in that the great majority are imported during the nine months when domestic produce is not available.

During 1987-89, principal agricultural imports included vegetables (averaging $38.3 million), fruits and nuts ($30.2 million) and plantation crops ($32.6 million). Most of the fruits imported cannot be produced

in Canada (bananas, mangoes, pineapples and grapefruit), are produced in very limited quantities (cantaloupes and melons) or are largely imported when they do not compete directly with Canadian production (tomatoes and grapes). Imports of plantation crops consist largely of coffee.

Major imports of processed agri-food products in 1989 included alcoholic beverages ($15.3 million), tomato paste ($3.8 million), frozen vegetables ($3.7 million) and frozen strawberries ($2.7 million - primarily for processing purposes). For the most part, these imports compete with Canadian production.

There appears to be good potential for Mexico to increase export supplies of both fresh and frozen fruits and vegetables, and alcoholic beverages, particularly beer.

Canada's Agri-Food Trade with Mexico - Average 1987 - 89
$ Millions

	Exports	Imports
Grains and products	21.1	1.8
Oilseeds and Products	70.4	--
Live animals	6.2	--
Red Meats & Animal Products	10.9	--
Dairy Products	34.6	--
Poultry & Eggs	0.8	--
Fruits & Nuts	0.3	32.0
Special Crops	3.6	--
Vegetables	0.1	38.3
Plantation Crops	--	32.6
Alcoholic Beverages	0.2	12.8
Other	1.0	2.0
Total Agri-Food	**149.1**	**117.8**
Total Trade	**538.0**	**1,399.7**
Agri-Food as a % of Total	27.7%	8.4%

Recent trade data indicate that Canadian exports of grains and oilseeds have lost grounds in the Mexican market while Canadian exports of pork and genetic material (mainly bovine) have increased.

Agri-food Regulations

Differences in the agri-food regulatory systems and procedures of Canada and Mexico can be a constraining factor in influencing business decision making to pursue agri-food trade opportunities. Among the regulatory differences between Canada and Mexico that have affected trading patterns are mandatory health and sanitary standards as they apply to horticultural, plant and meat products and animals.

Consideration of regulatory concerns affecting traded products has typically taken place in the context of regular consultative meetings among the three North American governments through institutions such as the North American Plant Protection Organization and tripartite animal health meetings. Further bilateral meetings of specialists have also occurred. Resolution of health and inspection issues ensures that animal, plant and human health are not compromised and that Canada's internationally recognized elite health status is not jeopardized.

The outcome of the Uruguay Round of Multilateral Negotiations on sanitary and phytosanitary issues will have a significant impact on the ultimate resolution of the current technical barriers that exist between Canada and Mexico. Expansion of the mechanism set up in the Canada-USA free trade agreement to resolve technical issues could be useful in developing North American harmonized standards.

Grains and Oilseeds

The three major cereal crops grown in Mexico are corn, wheat and sorghum. Average production for the 1985-86 to 1989-90 period was 10.1, 4.0 and 3.8 million tonnes, respectively. Average areas for the same time period were 6.0, 1.0 and 1.3 million hectares, respectively. Soybeans is the predominant oilseed crop, with 334,000 tonnes being produced on 142,000 hectares in 1988.

Mexico's grain imports are sporadic, depending upon domestic supply. Wheat and flour imports are generally distributed between the USA, Canada and Australia, with the US being the major source. Mexico imported 66,000 tonnes of Canadian wheat and flour in 1988-89 while imports from the USA were 1,067,000 tonnes. This should not be considered the average, as both the volume and the distribution among exporting countries varies considerably from year to year. A grains agreement, signed in early 1990, provides for the sale of Canadian wheat and barley to Mexico over the 1990 and 1991 calendar years.

The USA dominates the Mexican coarse grains import market. In 1987-88 Mexico imported a total of 3,715,000 tonnes of coarse grains, of which 3,707,000 tonnes was supplied by the USA. Argentina supplies the Mexican coarse grains market to a marginal extent while Canada does a minimal amount of business.

A bilateral agreement between the USA and Mexico would virtually eliminate Canada's presence in the Mexican grain market. The USA currently enjoys certain advantages with Mexico and a bilateral agreement would further enhance these advantages. Canadian grain exports would be subjected to continued licensing restrictions which USA exports would be excluded from, thereby reducing Canadian competitiveness.

A trilateral agreement would improve Canadian access to the Mexican market. Now that import restrictions are being relaxed, processors have the opportunity to deal directly with foreign exporters. They can be more selective regarding type, quality and source of grain that is best suited to their individual needs. In addition, a trilateral agreement would provide the opportunity for a more balanced trade environment. It is this opportunity which holds the greatest potential for exports of Canadian grains and oilseeds.

The Mexican market shows considerable potential, due to the high rate of population growth. Canada has begun to make inroads into this market and would be impeded if excluded from an agreement.

Special Crops

Mexico is a major consumer of pulse crops, particularly coloured beans. Increased support payments to pulse growers should enable Mexico to regain its former high level of self-sufficiency in coloured beans. For other pulse crops, Mexico will continue to be an importer.

Mexican pulse production averages about 1.3 million tonnes per year with dry beans accounting for about 85 %. The remainder is made up of dry peas, lentils, fababeans and chick peas.

Mexico imports of all pulses averages about $40 million per year and represents about 2% of all agricultural products. Canada's share of Mexican imports of pulses averaged about $5 million during the last two years or 12.5%. However, imports are variable from year to year depending on domestic production levels.

Both Canadian and American pulse growers are very efficient and price competitive. There is little threat that a Canada-USA-Mexico free trade agreement will adversely affect Canadian production. Moreover, preferential access could mean that we would maintain or expand exports, particularly to the benefit of Alberta and Manitoba growers. If Canada was not a party to the USA-Mexico free trade agreement, there is a possibility that Canada's pulse sector could lose its current competitive access position to the Mexican market, vis-à-vis the USA.

Horticulture

Annual Mexican imports of fresh fruits and vegetables represent less than 10% of exports. Climate and low labour costs allow Mexico to be competitive on the North American market in the production of a wide range of fruits and vegetables. In recent years there has been increased emphasis on the production of processed products, in particular frozen vegetables. Canada is a significant market for Mexican fruits and vegetables for

both fresh ($54.5 million) and processed ($11.4 million) products. However, exports to Canada represent only 5% of fruit and vegetable exports to the USA of $783 million fresh and $249 million processed in 1989.

A USA-Mexico free trade agreement, which would give the USA an advantage, would have limited impact on the Canadian exports of horticulture products to Mexico ($175,000 in 1989). USA exports of horticulture products to Mexico in 1989 were $116 million up 87% from 1988.

Mexican exports of fresh fruit and vegetables are geared to the late winter to early summer marketing period when North American produce prices are normally high. Improved access (i.e. lower tariffs) to Canadian markets would impact mainly greenhouse vegetables such as tomatoes, cucumbers and peppers. Currently, there is a trend toward increased Mexican production of summer vegetables. The more significant fact, in the longer term, is the ability of international companies to increase Mexico's output of processed vegetables (primarily frozen) for export. Increased exports of Mexican products to the USA may also have the effect of diverting some US products to Canada or competing with Canadian exports to the US. The USA market represents 90% ($673 million) of Mexican fruit and vegetable exports.

In terms of access to the Mexican market, a trilateral trade agreement would be more beneficial for USA horticulture than Canada, given the USA competitive advantage over Canada in horticultural products and the significant transportation cost of shipping from Canada. Participation in the trade negotiations would allow Canada to influence the outcome in this sensitive sector.

Red Meats

Improved economic conditions in Mexico will be necessary to increase per capita meat consumption which is relatively low compared to North American and/or world levels.

The USA is Mexico's major trading partner in livestock and red meat products. Mexico is a significant trading partner with the USA in both live beef cattle exports and dressed imports. Canada is the USA's chief foreign competitor in the Mexican market for livestock and livestock products.

Per capita beef consumption, in Mexico in 1988 was about 21 kg compared to 40 kg for North America and 12 kg for the world. Also beef consumption through the 1980s has been growing both through increased production from heavier market weights and increased imports.

Exports to Mexico of beef and veal products from Canada and particularly from the USA have increased sharply during the late 1980s. While Mexico is a leading world market for relatively low-priced beef offals (variety meats), exports of high-quality beef have also increased. Mexico is a small producer of high-quality feedlot beef but rising demand mainly from tourists outstrips local production.

Through the 1980s, pork production in Mexico generally declined. High feed costs and animal disease outbreaks have continued to limit Mexico's hog herd expansion with a corresponding rise in pork imports .

Mexico has become a growing market for USA and Canadian pork. Prior to the mid-1980s, Mexico imported very little pork. Pork variety meats (offals) continue to make-up the greatest share of Mexico's imported pork products.

Pork remains the preferred meat product of the Mexican consumers, according to the US Department of Agriculture. However, they are very responsive to changes in retail meat prices.

Livestock inventory levels in Mexico reflect limited arable land, water supplies, and especially acute supply-demand imbalances in the grains and oilseeds sectors. Mexico is not likely to become self-sufficient in livestock or in an export position in the near future. Notwithstanding changes in price controls and in ad valorem import tariff rates, a growing demand for breeding livestock and livestock products in Mexico should be anticipated by Canada.

Canada's chief foreign competitor in Mexico for livestock and meat products will continue to be the USA. Canadian participation in a North American trade agreement would ensure that Canada is in an equal position to take advantage of the export potentials in the expanding Mexican market.

Dairy

Canada exports dairy products to Mexico, in particular skim milk powder, pure-bred dairy animals, and bovine semen. Skim milk powder is our main dairy export. In fact, Mexico is our main purchaser of skim milk powder, accounting for $46 million or 60% of our skim milk powder exports in 1989. In terms of dairy genetic exports, for the period 1980-88, Mexico was our number two market (after the US). Annual Canadian sales over this period averaged $6 million.

Exports of skim milk powder are expected to diminish because of Canadian internal balance of skim milk powder to be reached within 5 to 10 years. Consequently, the Canadian participation in a North American free trade agreement will not have a significant impact on our skim milk powder sales to Mexicans.

Our exports to Mexico of live animals and bovine semen should not be affected to a great degree, considering that we are now trading in a competitive market. In fact, our exports of live animals are expected to increase over the coming years. However, this could be jeopardized if Mexico and the U.S. agree bilaterally to accord each other preferential treatment.

Poultry

Canada's trade with Mexico in the poultry and egg sectors has evolved in the context of certain significantly constraining characteristics, the foremost of which is the operation of a supply management in Canada which limits the potential for expansion or export market penetration. Additionally inadequacies in the Mexican inspection system and the presence of poultry diseases exclude Mexican product from Canada. Trade may take place in concert with direct foreign investment in Mexico and better control of health, sanitary and other quality factors at the Mexican production site.

A trilateral agreement would enable Canada to influence regulatory requirements and would provide Canadian breeder exporters with a better political and developmental framework.

A bilateral agreement would not necessarily change the sales of poultry breeding stock to Mexico since these products are already permitted free and equal access to the Mexican market. Expansion would be dependent on market development and the cultivation of inter and intra firm linkages.

There would appear to be little role for exports of Canadian final product as Mexico is largely self-sufficient in poultry. Exceptions to this may be low value parts and dark meat for which there is a high demand in Mexico, and turkey which Mexico has difficulty producing.

CONCLUSION

The Canadian agri-food sector has important interests to safeguard in the case of a Canada-USA-Mexico trade agreement. Currently, Canadian agri-food exports to the Mexican market are valued at $150 million per annum. Imports from Mexico, mainly complementary fresh and processed fruits and vegetables, were valued at $110 million. The protection of existing market access to Mexico (equal tariff opportunities compared to the USA and cooperative industry arrangements) and the prospective market opportunities (growth in Mexican population and incomes) mitigate in favour of participation in the trilateral trade negotiations.

The downside risks from not participating in such a trade negotiation could be the negotiation of a preferential USA-Mexico trade market to the benefit of the USA agri-food industry and potential loss of Canadian market share. A USA-Mexico agreement could put at risk traditional exports of Canadian grains, oilseeds, dairy products and a range of other developing export markets (semen, live animals). Additionally, it will be important to ensure that the access opportunities or competitive position for Canadian agri-food exports to the USA, secured under the CUSTA, would not be jeopardized under a USA-Mexico trade agreement.